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FEATURED REPORTS

In addition to the featured articles, members of the ComFin and UCC Committees have recently put together the featured reports available at the following links:

- A Brief Introduction to Offshore Registration and Financing of Yachts: A Presentation to the Business Law Section's Commercial Finance Committee
  by Mark J. Buhler

- Joint Article 9 Review Committee Meeting Notes for September 25-26, 2010
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UCC SPOTLIGHT

USEFUL LINKS AND WEBSITES

Reports from the Chairs

COMMERCIAL FINANCE COMMITTEE CHAIR REPORT

Programs … Get Your Programs (Fall Meeting November 4, 2009, Las Vegas)

Our Fall Meeting programs reflect some optimism about the economy – instead of all doom and gloom, we present fundamentals, our latest supermodel and a success story. Programs will include “Issues in Secured Financing – Recent Cases,” “Meet MICA – An Introduction to the Model Intercreditor Agreement,” and “Workouts that Worked Out.” Additional program information is available here and registration and hotel reservation information can be accessed here. The advance registration deadline is October 23, 2009 (you can register onsite after that date).

Thanks, Welcome Aboard and Not Fading Away

I’d like to thank our outgoing subcommittee chairs Michael Vernier (Aircraft Financing), Matt Kavanaugh (IP Financing), Jeff Kelley (Lender Liability) and Kathi Allen (Secured Lending) for all their support of the substance and growth of ComFin over the last three years. I’d also like to acknowledge the efforts of Brian Hulse, Jeremy Friedberg and Jim Prior, as editors, as well as all of the individual authors, in the publication of the ComFin Survey of Commercial Lending Laws: A State by State Guide. And special thanks and recognition to Stephen Sepinuck, who completed his term as chair of the UCC Committee this year, for being a scholar, a gentleman and a delight to work with.

Please join me in congratulating those in ComFin leadership who are taking on new roles – Peter Barlow and Marc Latman as the incoming chair and vice chair of Aircraft Financing, John Murdock as the incoming chair of IP Financing, Mathew Rotenberg and Vivien Kelley as the incoming chair and vice chair of Lender Liability and Wansun Song and Heather Sonnenberg as the incoming chair and vice chair of Secured Lending. Also, Matt Kavanaugh, Kathi Allen, John Murdock and David Fournier will lead our newly formed Model IP Security Agreement Taskforce (MIPSA).

It’s the Latest, It’s the Greatest, It’s the ComFin Webpage

Materials from the 2009 Spring and Annual Meetings are posted to the ComFin home page.

Call (or, since I’m not Blondie, e-mail) Me

Please email me if you have suggestions for programs, projects, publications or other activities that would make ComFin a more valuable resource to you.

Lynn

ComFin Committee Chair

UNIFORM COMMERCIAL CODE COMMITTEE CHAIR REPORT

Greetings and Thanks

I am delighted to have the opportunity to serve you as the new chair of the UCC Committee.
MARK YOUR CALENDARS

October 27, 2010 – 4:30 p.m. EST – Issues Related to Agented Deals - New York, New York. The Association of Commercial Finance Attorneys will present a program moderated by Jerry Harwitza, “Issues Related to Agented Deals,” on Tuesday, October 27, at 4:30 p.m. More information will become available here.

November 4, 2009 – Joint ComFin and UCC Fall Meeting - Las Vegas, Nevada. Viva Las Vegas. The Joint ComFin and UCC Meeting will be held Wednesday, November 4, 2009, in Las Vegas, Nevada, in conjunction with the Commercial Finance Association Annual Convention. Fall Meeting program details and registration and hotel information are available here and information about the CFA convention is available on their website.

November 20-21, 2009 - 2009 Section Fall Meeting - Washington, D.C. The ABA Business Law Section Fall Meeting will be held in Washington, D.C. at The Ritz Carlton. More information is available here.

April 22-24, 2010 - Business Law Section Spring Meeting – Denver, Colorado. Save the Date! Please join us in mile-high Denver, Colorado this Spring for numerous CLE programs, committee and subcommittee meetings and an exciting spread of social networking events. More details will become available at the ABA Business Law Section’s website.

Please join me in extending many thanks to outgoing chair Stephen Sepinuck for his outstanding leadership. Stephen’s scholarly contributions to the committee will continue through the popular Spotlight column provided in this Newsletter.

A sincere thank you goes out to Kristen Adams, Tom Buiteweg and Norm Powell for graciously “volunteering” to serve as Vice-Chairs of the UCC Committee; they make a distinguished trio.

A number of UCC subcommittees also have dynamic new leadership. Please extend a warm welcome to Peter Have, new vice-chair of the International Commercial Law Subcommittee, Larry Safran, new vice-chair of the Letter of Credit Subcommittee, Janet Nadile, new vice-chair of the Secured Transactions Subcommittee, and Kathi Allen, vice-chair of the new Model IP Security Agreement Taskforce.

You may have noticed our new Newsletter format. Thanks to the untiring and innovative ideas of our Commercial Law Newsletter editors and Frank Hillis at the ABA staff, this issue of the Newsletter has a spiffy new look. The changes include direct links to the Subcommittee pages (where the reports are posted), fewer attachments and fewer pages. The new format makes it easier for those of you who need to grab and go with a copy of the Newsletter in hand. If you have any comments and suggestions regarding the new look, please be sure to let any one of the Editors know. We value your input.

New UCC Fall Programming (November 4, 2009, Las Vegas)
This year, we are joining the ComFin Committee in Las Vegas for a new one-day joint fall meeting consisting of three CLE programs. Steve Sepinuck will serve as the “talk show host” of a program involving audience participation (and advance preparation) on issues from recent secured financing cases. The ComFin Committee’s Model Intercreditor Agreement Task Force will unveil their completed Model Intercreditor Agreement. Finally, a group of practitioners will outline the elements of a successful workout. The Program information is available here and registration and hotel reservation information can be accessed here. The advance registration deadline is October 23, 2009 (you can register onsite after that date).

UCC Committee Webpage
Please take a moment to browse the subcommittee webpages, which have just been updated to summarize what our various subcommittees have been doing and substantive developments. You may access the UCC Committee website by clicking here.

New Ideas
Please email me if you have any ideas for the UCC Committee or wish to participate in any project or leadership role. I very much welcome any and all participation.

Penny
UCC Committee Chair
THE MYSTERIES OF CONSIGNMENTS, SALE OR RETURN, BAILMENTS, AND OTHER WAYS TO MYSTIFY THE TRUSTEE IN BANKRUPTCY

By James D. Prendergast

This article discusses some of the major legal issues considered at a program presented by the Secured Transactions/Secured Lending Subcommittee (of the UCC/ComFin Committees) at the Annual Meeting of the Business Law Section of the American Bar Association (the “Program”) held in Chicago on Sunday, August 2, 2009. The mission of the Program was to delve into the mysteries of title retention arrangements including consignments between suppliers of raw materials or equipment and their manufacturing customers, or between manufacturers and their wholesale or retail dealers. Are consignments Article 9 secured transactions? Or Article 2 sales transactions? Or bailments? Or something else altogether? What about just-in-time inventory arrangements and their title transfer provisions?

The initial point of consideration of title retention arrangements was the scope of Article 9. Pursuant to §9-109, except as otherwise provided in subsections (c) and (d) thereof, Article 9 applies to: (1) a transaction, regardless of its form, that creates a security interest in personal property or fixtures by contract ... (4) a consignment. Article 9 applies to “a transaction, regardless of its form, that creates a security interest in personal property or fixtures by contract,” per §9-102 (a) (1). Regardless of how parties structure or label a transaction, if the transaction creates what is in substance a security interest – that is, if in substance it creates “an interest in personal property or fixtures which secures payment or performance of an obligation,” per the definition of “security interest” in §1-201 (37) – then a court will view the transaction as creating a security interest and hence subject to Article 9.

In In re American Home Mortgage (379 B.R. 503; 58 Collier Bankr. Cas. 2d; 49 Bankr. Ct. Dec 93; Bankr. L. Rep. P 81, 228; Jan 4, 2008) the Delaware bankruptcy court held: “Under New York law, when interpreting a contract, the court should arrive at a construction which will give fair meaning to all of the language employed by the parties to reach a practical interpretation of the expression of the parties so that their reasonable expectations will be realized. ... Where the intention of the parties is clearly and unambiguously set forth, effect must be given to the intent as indicated by the language used. Finally, where the contract is clear and unambiguous on its face, the intent of the parties must be gleaned from within the four corners of the instrument. If the contract is clear, the court will not look further for meaning” (p. 17). The clear error of this case has lead to a suggested Official Comment Change to §9-109: 2. Basic Scope Provision. Subsection (a)(1) derives ... or the name that parties have given to it. Likewise, the subjective intention of the parties with respect to the legal characterization of their transaction is irrelevant to whether this Article applies, as it was to the application of former Article 9 under the proper interpretation of former Section 9-102.

Another method of title retention is a lease that is a disguised security interest. Section1-203 of the UCC states that in analyzing a lease to make this determination: “The key is whether the buyer/lessee is obtaining more than the right to possess or use the goods for a period of time and whether the seller/lessor is retaining a meaningful residual interest in the goods.” Whether a transaction in the form of a lease creates a lease or security interest is determined by the facts of each case.
DO YOU WANT TO...

- WRITE FOR AN OFFICIAL ABA PUBLICATION?
- GET PUBLISHED, WITHOUT TOO MUCH OF A TIME COMMITMENT?
- CONNECT WITH OTHER MEMBERS OF THE COMFIN AND UCC COMMITTEES?

If so, submit an article for possible publication in a future issue of the Commercial Law Newsletter. Publishing an article with the Commercial Law Newsletter is a great way to get involved with the ComFin Committee and the UCC Committee. Articles can survey the law nationally or locally, discuss particular commercial finance or UCC issues, or examine a specific case or statute. If you are interested in submitting an article, please contact one of the Commercial Law Newsletter Editors – Lauren E. Wallace, Carol Nulty Doody or Christine Gould Hamm.

A consignment is a transaction in which a person delivers goods to a merchant for the purpose of having the merchant sell the goods on behalf of the consignor. Thus, a consignment is a species of bailment: it is a bailment of goods to a merchant, coupled with a grant of power to the merchant to sell the goods. As an example of a consignment transaction, suppose that O (for “owner”) owns a valuable painting that O wishes to sell. O has a friend, M (for “merchant”), who owns an art gallery. O might enter into a consignment arrangement with M. Under the arrangement O would deliver the painting to M, who would hang it in his gallery, and M would have authority from O to sell it. If M does sell it, M would be entitled to retain an agreed commission, and would pay the balance of the sale price to O. The painting remains O’s property until sold, however, and if it isn’t sold M would ultimately return it to O, with no liability on M’s part to O. Consignment is a common method of distributing goods in bulk in some industries. For instance, it is not uncommon for a manufacturer or wholesaler of textiles to sell textiles through a consignment arrangement with a retailer, in this case the manufacturer/wholesaler playing the role of O in the above example with the retailer playing the role of M.

A consignment transaction such as the one just described is not a lien transaction. But if the terms are bent a bit, a consignment might become economically indistinguishable from a lien transaction, to the degree that the so-called consignment should be recharacterized as a lien transaction. To illustrate this, suppose that instead of O and M entering into the consignment just described, they enter into the following arrangement: O sells the painting outright to M, on 100% credit (i.e., M pays no money down); O retains a security interest in the painting to secure M’s obligation to payub the price. Economically, what difference is there between that arrangement and the consignment arrangement? The most important difference is that in the consignment transaction M doesn’t have to pay O for the painting unless M sells it, while in the sale-with-retained-security-interest arrangement M will have to pay O for the painting on the agreed payment date, whether or not M has sold the painting.

A consignment agreement is at risk of being recharacterized as a sale-with-retained-security-interest, therefore, if the agreement between M and O contains terms that have the effect of making M pay for the goods whether or not M has sold them. In real life Ms and Os often do agree to provisions that require M to pay for the goods in at least some circumstances. And so it is often difficult to tell whether a given consignment is a true consignment or should be recharacterized as a lien transaction.

The main consequence of the inclusion of true consignments within Article 9 relates to the priority of O in the consigned goods against a third party who claims an interest in the consigned goods in M’s hands, such as a creditor of M. The key point is that in order for O to attain priority over such a third party, O must perfect its ownership interest in the consigned goods, by filing a financing statement against M. If O fails to perfect its ownership interest, O’s rights in the consigned goods in all likelihood will be trumped by the rights of M’s creditors (including M’s trustee in bankruptcy).
If a transaction does not fall within the definition of “consignment” in Article 9, it may be a sale or return. Or it may not be. By definition, a transaction is not a sale or return unless the buyer can return the goods. As comment 1 to §2-326 confirms, a “sale or return” is a sale. If a transaction contemplates delivery to a buyer, who will resell them, it may be a sale or return. However, if the transaction contemplates delivery to someone who does not buy or contract to buy them from the person making delivery, the transaction is not a sale or return.\(^3\)

Finally - An Intriguing Hypothetical:

Suppose Consignor delivers silver bullion (.999 pure) to Sterling Silver Manufacturer (SSM), pursuant to an agreement which purports to be a “consignment” and allows for return of the bullion within 6 months. The “consignment” agreement allows the bullion to be commingled, in the ordinary course of business. Consignor files a financing statement and its “consignment agreement” includes a granting clause describing the bullion. SSM combines the silver with copper to make sterling silver (.925 silver) and then manufactures it into tea sets. Secured Party 1 makes a loan, takes a security interest in all “tea set inventory” and files a financing statement on January 1, 2007. On July 1, 2007, Consignor files a financing statement, does a search and sends a notice to everyone that has filed a financing statement against SSM stating that Consignor will be selling silver bullion to SSM on consignment. On August 1, 2007, Consignor sells silver to SSM. By September 1, that silver was made into tea sets (but not yet sold to SSM’s customers).

i. Can the “consignment” be a true consignment if the consignee is allowed to convert the asset into a form where it cannot be returned to the consignor?

ii. Once the silver becomes commingled, first with copper to become sterling silver, and then is processed to become a tea set, is it still “purchase money goods”?

iii. Asking (ii) another way, in a priority fight between Secured Party 1 and Consignor that arises after all the silver has been made into tea sets, who has priority? Is it consignor as the holder of a purchase money security interest in the silver inventory (and then as the holder of a security interest in the “product” under 9-336)? Or, is it Secured Party 1, as the secured party that filed first (and does not get its security interest under 9-336), as covered by the example in Official Comment 7 to 9-336?\(^5\)

This hypothetical was considered when the panel reviewed a number of cases concerning title retention arrangements. Among the cases was In re Georgetown Steel, Inc., 318 B.R. 352 (Bankr. D. S.C. 2004). Hot briquette iron (“HBI”) is one of those things no one outside the steel industry will know much about. There is actually a Hot Briquetted Iron Association that lists six members, 16 “associates” and eight “traders.” In other words, it is a clubby niche industry. One of those associate members is Progress Rail Services, a subsidiary of Caterpillar. It supplied HBI to Georgetown Steel, which, as the case name indicates, later went bankrupt. Under Progress Rail’s agreement with Georgetown Steel, the HBI was kept separate from Georgetown Steel’s other inventory, and removed on an as-needed basis, at which point Progress Rail would invoice Georgetown Steel. Like every other losing consignor here, Progress Rail did not file a financing statement. CIT had a first position perfected security interest in Georgetown Steel’s inventory. When Georgetown Steel filed for bankruptcy protection, the mill closed and there was no need for the HBI on its premises, so it was stipulated that the HBI would be sold and the court would determine who had rights to the proceeds. The parties agreed that most of the criteria in 9-102(a)(20) to classify the transaction as a consignment were met, with the main exception that Progress Rail claimed that the HBI was not supplied to Georgetown Steel “for the purpose of sale.”

It’s not hard to understand Progress Rail’s position. The only people who would be holding on to HBI “for the purpose of sale,” using the ordinary meaning of the term, would be the six members, 16 associates and eight traders in the Hot Briquetted Iron Association. The people to whom they would sell the HBI, other than to one another, would be steel mills. Steel mills, in turn, wouldn’t be selling the HBI; they would be incorporating the HBI into steel. Therefore, the argument, concludes, this wasn’t an Article 9 consignment and the failure to file a financing statement should not be fatal to Progress Rail’s rights to the HBI.

Unfortunately for Progress Rail, it didn’t work out that way. The second paragraph of comment 14 to 9-102 describes what “for the purpose of sale” means for the purpose of 9-102(a)(20), and that purpose is a lot broader than Progress Rail’s argument.

The definition of “consignment” requires that goods be delivered “to a merchant for the purpose of sale.” If the goods are delivered for another purpose as well, such as milling or processing, the transaction is a consignment nonetheless because a purpose of delivery is “sale.”
In other words, “purpose of sale” essentially means “the purpose of sale or the purpose of being incorporated into something else that will be sold.”

Progress Rail had four other arguments, which the court similarly dismissed. First, it argued that Georgetown Steel wasn’t a merchant, and therefore 9-102(a)(20) didn’t apply to it, because it didn’t “deal in goods of that kind.” The court held that one who purchases a raw material for incorporation into a product it sells in its business and deals in goods of that kind is a merchant. Second, Progress Rail argued that the transaction did not secure an obligation, thus coming under the exception in 9-102(a)(20)(D). The court had little trouble deciding that since Progress Rail expected to be paid its unpaid purchase price, that price was an obligation. Third, it argued that the transaction came more properly under Article 2 than Article 9. The difficulty Progress Rail had there was that it had drafted its contract too well. Since, under its contract, the actual sale occurred when the HBI was taken out of inventory and consumed by Georgetown Steel, it was not allowed to argue that there was a sale when the HBI was not taken out of inventory. Finally, it argued that the contract was merely a bailment and Georgetown Steel was its agent. That didn’t work either because there was nothing in the contract that would require the HBI to be returned to Progress Steel.

Essentially, this was a just-in-time supply agreement, the cutting edge of the 80s, the mainstay of the 90s and the old-hat of the 00s. And the basic lesson of Article 2 and Article 9 for a just-in-time supply agreement is to file a financing statement and make it a purchase money security interest in inventory, 9-103(d).

However, in an open discussion, almost everyone in attendance at the Program considered the Georgetown Steel case to be wrongly decided notwithstanding the Official Comment. To think otherwise would turn all raw material inventory into consigned inventory. The difficulties Title retention arrangements and secured transactions. Where to draw the lines in a fact pattern can be difficult. However, you cannot even attempt to draw the lines unless you know the rules by which the lines are to be drawn.

GGP DECISION HOLDS SPEs NOT BANKRUPTCY PROOF

By Stuart Saft, Partner, Dewey & LeBoeuf LLP

On August 11, 2009, the United States Bankruptcy Court for the Southern District of New York in In re Growth Properties, Inc., et al. ruled that bankruptcies of Special Purpose Entities (SPEs) orchestrated by replacing their independent members without advising them (or their lenders) of being replaced for seven weeks were not “bad faith filings,” even in the instances of solvent SPEs with positive cash flows and no substantial maturities in the near term. The decision requires lenders to overhaul the loan and security agreements and governance of the SPEs used in structuring these loans.

The issue in the case was the control of the SPE that was established in order to prevent a bankruptcy filing without the approval of the SPE’s independent directors or managers. However, the court took judicial notice of the fact that GGP’s capital structure required that GGP be continuously able to refinance and that, in the latter half of 2008, the crisis in the credit markets precluded GGP from refinancing both its maturing debt and its debt that reached its anticipated repayment date when the loans would require amortization.

In April, 2009, GGP and 360 of its affiliates filed for protection under Chapter 11 of the Bankruptcy Code and moved for permission to use cash collateral, including the cash produced by the SPEs. In the GGP decision, the court held that the cash flow from the successful properties could be used to support all of GGP notwithstanding that the properties were owned by separate SPEs. Judge Gropper noted that just because an SPE is bankruptcy remote does not mean that it is bankruptcy proof.

Judge Gropper then raised an issue that has to send a chill throughout the lending community by noting that “there is no question that the SPE structure was intended to insulate the financial position of the Subject Debtors from the problems of its affiliates, and to make the prospect of a default less likely. There is also no question that this structure was designed to make each Subject Debtor ‘bankruptcy remote’. Nevertheless, the record also establishes that the Movants each extended a loan to the respective Subject Debtor with a balloon payment that would require refinancing in a period of years and that would default if financing could not be obtained by the SPE or by the SPE’s parent company coming to the rescue.” (Emphasis added.) Accordingly, the fact that the parent entity might have to rescue the affiliate at some point in the future was a sufficient nexus for the Bankruptcy Court to rule that the SPE could file a Chapter 11 petition in good faith.

The decision then examined the role of the Independent Managers of the SPE in voting for the Chapter 11 filing and points out that, because the SPEs were formed under Delaware law, the directors/managers were obligated to consider the interests of the shareholders (the holding companies) in exercising their fiduciary duties. Therefore, notwithstanding the purpose of the SPE, the Independent
Managers did not (and, in fact, should not) consider the needs of the secured lenders in making the decision to file for Chapter 11.

One of the surprising elements of the decision is GGP’s firing of the Independent Managers prior to the Chapter 11 filing and GGP’s failure to notify not only the lenders and servicers, but waiting seven weeks before informing the fired Independent Managers that they had been replaced. The judge did not believe that such an action demonstrated bad faith because there was no specific requirement that notice be given.

The most significant aspect of the GGP decisions is that the existing SPE structure did not achieve the desired goals of protecting the lender’s cash collateral. If the SPE structure is to be available as a tool for real estate financing in the future, it will have to be revamped to avoid any possibility that the GGP situation can reoccur. Such changes could include:

1. The SPE transactions should be recast using security contracts and/or other contracts the Bankruptcy Court is powerless to enjoin under Sections 555, 556, 559, 560, and 561 of the Bankruptcy Code so that on a default such as the bankruptcy of the SPE or its holding company, the lender may terminate the contract and liquidate the collateral security such as the deed to the real property.

2. Require the servicers’ prior written consents to replace an independent director/manager and to identify each replacement.

3. The cash flow from the property should be assigned to the servicer and paid into a lock box, which diminishes the debtor’s ability to deploy it for unapproved purposes prior to bankruptcy.

4. The SPE’s certificate of incorporation or operating agreement should provide that a) a bankruptcy filing cannot occur without the approval of all the directors/managers, and b) the directors/managers owe duties to protect secured creditors in the enforcement of their contractual rights, including remedies.

NEW YORK AMENDS LAW REGARDING POWERS OF ATTORNEY

By Mark S. Vecchio, Partner, Venable LLP

Concerned by increasing reports of abuse involving senior citizens in the context of estate planning, the New York State Legislature recently adopted amendments to the General Obligations Law setting forth changes to the law affecting the validity of powers of attorney executed in New York. The changes are effective as of September 1, 2009.

The changes affect only those powers of attorney executed by individuals as principals. Powers of attorney issued by partnerships, limited liability companies, corporations or other entities remain unaffected by the new law. Similarly, the law applies only to powers of attorney executed in New York State – regardless of whether or not the individuals executing such powers are domiciliaries of New York – but they apply to all such powers, irrespective of the law which otherwise governs the power. The validity of powers of attorney executed outside of New York State by New York domiciliaries will continue to be governed by the law of the place of execution of each such power of attorney.

The amendments in question introduce changes to Sections 5-1501 et seq. of the New York General Obligations Law. For example, Section 5-1501A now provides that a power of attorney is “durable” (i.e., not affected by later incapacity of the principal), unless it specifically provides that it is terminated by the principal’s incapacity.

Section 5-1501B(1) sets forth new requirements concerning the validity of powers of attorney. In order to be valid, a power of attorney must:

(a) be typed or printed using letters which are legible or of clear type no less than twelve point in size, or, if in writing, a reasonable equivalent thereof; and

(b) be signed and dated by both the principal and the agent (i.e., the attorney-in-fact) (NB: prior law did not require signature by the agent).

In addition, both the principal’s and the agent’s signatures must be “acknowledged in the manner prescribed for the acknowledgment of a conveyance of real property” (i.e., notarized by a duly qualified notary public).
Powers of attorney executed by individuals in New York must now contain the following language, verbatim:

CAUTION TO THE PRINCIPAL:

Your Power of Attorney is an important document. As the “principal,” you give the person whom you choose (your “agent”) authority to spend your money and sell or dispose of your property during your lifetime without telling you. You do not lose your authority to act even though you have given your agent similar authority.

When your agent exercises this authority, he or she must act according to any instructions you have provided or, where there are no specific instructions, in your best interest. “Important Information for the Agent” at the end of this document describes your agent’s responsibilities. Your agent can act on your behalf only after signing the Power of Attorney before a notary public.

You can request information from your agent at any time. If you are revoking a prior Power of Attorney by executing this Power of Attorney, you should provide written notice of the revocation to your prior agent(s) and to the financial institutions where your accounts are located.

You can revoke or terminate your Power of Attorney at any time for any reason as long as you are of sound mind. If you are no longer of sound mind, a court can remove an agent for acting improperly.

Your agent cannot make health care decisions for you. You may execute a “Health Care Proxy” to do this.

The law governing Powers of Attorney is contained in the New York General Obligations Law, Article 5, Title 15. This law is available at a law library, or online through the New York State Senate or Assembly websites, www.senate.state.ny.us or www.assembly.state.ny.us.

If there is anything about this document that you do not understand, you should ask a lawyer of your own choosing to explain it to you.

IMPORTANT INFORMATION FOR THE AGENT:

When you accept the authority granted under this Power of Attorney, a special legal relationship is created between you and the principal. This relationship imposes on you legal responsibilities that continue until you resign or the Power of Attorney is terminated or revoked. You must:

(1) act according to any instructions from the principal, or, where there are no instructions, in the principal’s best interest;

(2) avoid conflicts that would impair your ability to act in the principal’s best interest;

(3) keep the principal’s property separate and distinct from any assets you own or control, unless otherwise permitted by law;

(4) keep a record of all receipts, payments, and transactions conducted for the principal; and

(5) disclose your identity as an agent whenever you act for the principal by writing or printing the principal’s name and signing your own name as “agent” in either of the following manner: (Principal’s Name) by (Your Signature) as Agent, or (your signature) as Agent for (Principal’s Name).

You may not use the principal’s assets to benefit yourself or give major gifts to yourself or anyone else unless the principal has specifically granted you that authority in this Power of Attorney or in a Statutory Major Gifts Rider attached to this Power of Attorney. If you have that authority, you must act according to any instructions of the principal or, where there are no such instructions, in the principal’s best interest. You may resign by giving written notice to the principal and to any co-agent, successor agent, monitor if one has been named in this document, or the principal’s guardian if one has been appointed. If there is anything about this document or your responsibilities that you do not understand, you should seek legal advice.

Liability of agent:

The meaning of the authority given to you is defined in New York’s General Obligations Law, Article 5, Title 15. If it is found that you have violated the law or acted outside the authority granted to you in the Power of Attorney, you may be liable under the law for your violation.

Corporate and finance lawyers are advised to pay particular attention to the new law, in view of the fact that many financing documents - including loan agreements, promissory notes, settlement agreements, acquisition agreements, voting trusts, lock-up agreements, joint venture agreements, security agreements, licenses and other forms of contractual undertakings - often include imbedded provisions
pursuant to which one party (ordinarily, although not exclusively, a borrower) purports to grant a power of attorney to another party under certain circumstances. To the extent individuals executing such documents in New York are acting in their own name and on their own behalf as principals (i.e., are not acting as an officer, manager, partner, employee, director, agent or representative of a corporation or other entity), any imbedded grant of a power of attorney risks being held unenforceable in New York, if it fails to comply with New York’s new rules governing powers of attorney. In such circumstances, practitioners are advised to create separate written powers of attorney to ensure that the various elements of New York law are complied with.

Finally, Section 5-1504 makes it clear that powers of attorney validly issued prior to September 1, 2009 remain in effect, notwithstanding the foregoing statutory changes. However, a somewhat unfortunately worded provision of Section 5-1511(6) provides that, as of September 1, 2009, unless the principal expressly provides otherwise, the execution of a power of attorney revokes any and all prior powers of attorney executed by the principal — not just powers of attorney executed by the principal in favor of the agent(s) named in such power. A technical corrections act currently pending in the New York State Legislature would revise the new law so that subsequently executed powers would not revoke all previously executed powers of attorney. Pending enactment of such bill, however, care should be taken to expressly state that a power of attorney does not revoke prior powers of attorney, in order to avoid inadvertent revocation of existing powers.

TERMINATION PREMIUMS PAYABLE TO THE PBGC SURVIVE CHAPTER 11 BANKRUPTCY PROCEEDINGS

By Cleary Gottlieb Steen & Hamilton LLP

On April 8, 2009, the United States Court of Appeals for the Second Circuit overturned a bankruptcy court’s decision regarding the treatment of the “termination premium” imposed on a sponsor of a pension plan that was involuntarily terminated by the Pension Benefit Guaranty Corporation (“PBGC”). This decision could have an important effect on debtors with defined benefit pension plans terminated during a Chapter 11 bankruptcy proceeding.

The PBGC is the federal entity responsible for insuring the payment of promised retirement benefits under broad-based corporate pension plans. When an underfunded pension plan is terminated, the PBGC takes over administration of the plan and guarantees a certain minimum level of benefits to participants. Under the Employee Retirement Income Security Act of 1974, as amended (“ERISA”), when a defined benefit pension plan is terminated either by the PBGC in an involuntary termination or by the plan sponsor in a distress termination, the plan sponsor must pay a “termination premium” to the PBGC. The termination premium obligation was implemented as part of the Deficit Reduction Act of 2005 in an attempt to reduce the growing deficit in the PBGC’s budget, and to make termination of underfunded plans less appeal ing to plan sponsors. The statute requires the sponsor of a plan terminated involuntarily or in a distress termination to pay $1,250 per year, per participant, for three years.10 Payment of the premium generally begins in the first month following the month in which the plan termination occurs. However, when the plan is terminated in connection with a Chapter 11 bankruptcy proceeding, the statute delays the payment obligation until the first month following the discharge of the debtor from bankruptcy.

Last year, the United States Bankruptcy Court for the Southern District of New York in Oneida Ltd. v. Pension Benefit Guaranty Corp. 383 B.R. 29 (S.D.N.Y. 2008), addressed whether the duty to pay the termination premium payment could be considered a “claim” subject to compromise in a bankruptcy process. Within a Chapter 11 restructuring proceeding, all “claims” against the debtor must be discharged by the bankruptcy court upon confirmation of the debtor’s plan of reorganization. The debtor argued that the obligation to pay the termination premium was a contingent “claim” under Section 101(5)(A) of the Bankruptcy Code. The Court agreed, holding that the term “claim” is broadly defined in the Bankruptcy Code and that it includes contingent future rights to payment. The Court further held that the obligation was properly characterized as a prepetition claim, and that it was therefore necessarily discharged upon confirmation of the debtor’s plan of reorganization, releasing Oneida from any duty to pay the termination premium upon its emergence from bankruptcy, other than as an unsecured claim under the debtor’s plan of reorganization.

The PBGC appealed the decision, and, on April 8, 2009, the Second Circuit Court of Appeals reversed the lower court’s ruling. The Second Circuit held that the existence of a valid prepetition “claim” depends on whether the claimant possessed a right to payment, and whether that right arose before the filing of the petition; in the case of a termination premium arising in connection with a Chapter 11 reorganization, the obligation to pay does not arise until the bankruptcy process is complete, and therefore could not be considered a “claim” within the process. The Second Circuit stated that “no matter how broadly the term ‘claim’ is construed, it cannot extend to a right to payment that does not yet exist under federal law.” Further, the Court held that Congress’ specific intent to preserve and delay payment of termination premiums in a bankruptcy reorganization must be respected and would trump other general standards contained in Chapter 11 of the Bankruptcy Code.
The Second Circuit ruling is the first published decision on this issue, representing the opinion of a respected appellate court interpreting a statute that, in the Court’s view, is unambiguous. While it is possible that other courts addressing the issue will disagree with the conclusion, debtors should be careful to consider the Second Circuit’s ruling for two principal reasons.

First, a debtor that emerges from the reorganization process would, under the ruling, be liable for the full amount of the termination premium, which must be paid over the three years following approval of the plan of reorganization. The obligation may be significant in the context of the capitalization of the debtor upon emergence from bankruptcy.

Second, while ERISA contemplates that a debtor will not be liable for the termination premium until its emergence from bankruptcy, which is consistent with the Second Circuit’s decision, regulations issued by the PBGC provide that all members of the controlled group as of the day before the date of plan termination are jointly and severally liable for the termination premium. The regulations therefore look back to a time when, under the statute and the Oneida ruling, the right to payment does not exist since the plan sponsor has not completed the bankruptcy process. In the context of a Chapter 11 case, then, the PBGC may take the position that the members of a debtor’s controlled group not subject to the bankruptcy proceedings (i.e., non-debtor subsidiaries) are immediately liable for such termination fees even though collection against the debtor is stayed. While that position seems inconsistent with the language of the statute and the Second Circuit’s recent holding, debtors in Chapter 11 cases need to be mindful of the potential controlled group liability. In particular, if the debtor contemplates asset sales or other divestures during the bankruptcy proceeding, the controlled group liability may pose issues for potential buyers.

**UCC Spotlight**

By Stephen L. Sepinuck, Professor, Gonzaga University School of Law; Former Chair of the UCC Committee and Kristen Adams, Professor, Stetson University College of Law; Vice-Chair of the UCC Committee

The purpose of this column is to identify some of the most disconcerting judicial decisions interpreting the Uniform Commercial Code or related commercial laws. The purpose of the column is not to be mean. It is not to get judges recalled, law clerks fired, or litigators disciplined for incompetence. Instead, it is to shine a spotlight on analytical errors, and thereby provide practitioners and judges with reason to disregard the opinion.

_In re Montagne_, 2009 WL 2481982 (Bankr. D. Vt. 2009)

This is a case about perfection of a security interest in proceeds of original collateral. The court adeptly waded through many arguments, wisely jettisoning the most spurious, and it may have even reached the correct result. Unfortunately, its analysis floundered in the most important issues, and attorneys should seek out more solid footing when tackling such issues.

The story begins in 2005, when Ag Venture acquired a security interest in the livestock of Montagne Heifers, Inc. (“MHI”) to secure a $457,000 loan. MHI, which operated a dairy farm in Vermont, was owned by Michael and Diane Montagne, a married couple. Both Michael and Diane guaranteed MHI’s debt to Ag Venture. In 2006, Michael and Diane separated. In 2007, Ag Venture released Diane from liability on the debt.

Later in 2007, Michael purchased some shares in MHI from his son, John, and granted John a security interest in the livestock to secure the unpaid portion of the purchase price. At this point, neither Ag Venture nor John had filed a financing statement. Then, in quick succession, four critical events happened: (i) on November 24, MHI sold cows for $500,000; (ii) on November 28, Michael transferred a $240,000 check received in partial payment of the purchase price to Diane; (iii) on November 30, Ag Venture filed a financing statement; and (iv) on December 4, John filed a financing statement. A dispute then arose as to who among Ag Venture, John, and Diane had priority in the check.

The court first dealt with whether Ag Venture had a security interest in the livestock and its proceeds. It properly rejected an argument that the collateral description in the security agreement was insufficient, noting that both “livestock” and “proceeds” are Article 9 categories of collateral and that is all that’s required under § 9-108.

The court then analyzed whether Ag Venture waived its security interest in the livestock or its proceeds. Diane had argued that by releasing her from liability on the secured loan, Ag Venture had released its interest in the collateral. This argument is patently ridiculous and the court so ruled. The court properly distinguished between an obligor’s personal liability on the loan and the in rem liability of the collateral. However, the court went further and in so doing, went a bit astray. The court concluded that Ag Venture “did not authorize or acquiesce in the disposition of the Collateral by the Debtor, and thus did not waive its security interest in the Proceeds.” This statement is confused. While an authorization to sell collateral free and clear does operate as a waiver of the security interest in the original collateral sold, it does not operate as a waiver of the security interest in proceeds. This is evident from the text of § 9-315(a). Paragraph (1), which deals with the continuity of the security interest in the original collateral sold, includes an exception for sales authorized free and clear. In contrast, paragraph (2), which provides that a security interest attaches to proceeds, contains no such exception. Indeed, in...
the normal case, a secured party authorizes a sale free and clear in order to get all or some of the proceeds. The court’s dicta on this point is regrettable.

The court moved on to discuss perfection, and started that discussion quite well. The court noted that the names of the debtor and the secured party were correct and that the description of the collateral as “livestock” and “proceeds” was sufficient. The court then rejected an argument that the financing statement was ineffective because it contained an allegedly inaccurate address for the debtor. The court properly noted that under the “seriously misleading” test of § 9-506(a), an incorrect address would be immaterial. Moreover, the court rejected an argument that the two-year delay in filing somehow undermined Ag Venture’s perfection. It pointed out, correctly, that the 20-day period to perfect in § 9-324(a) related only to the priority of a purchase-money security interest, not to perfection.

The court then dealt with the fact that Ag Venture’s financing statement was filed after the debtor had sold the livestock. Here is where the court went significantly off course. The court ruled that it had “previously found that Ag Venture properly perfected in the original collateral – the livestock – on November 30, 2007. Therefore, Ag Venture’s security interest in the Proceeds of that Collateral was likewise perfected as of that date.” In fact, the court had not previously ruled that Ag Venture’s security interest in the livestock was perfected, merely that it had attached and that the filing was proper. Moreover, any such ruling would likely have been wrong. Recall that the debtor had sold the livestock before Ag Venture filed. Accordingly, the buyer took free of Ag Venture’s security interest in the livestock as long as it acted without knowledge of it. See § 9-317(b). Even if the buyer had not taken free of the Ag Venture’s security interest, the sale made the buyer, not MHI, the “debtor.” See § 9-102(a)(28) (defining “debtor” as the person having an ownership interest in the collateral). Thus, Ag Venture’s later filing against MHI would probably not have been effective to perfect a security interest in the livestock now owned by MHI’s buyer. In short, Ag Venture’s security interest in the livestock sold was never perfected.

Even if Ag Venture’s security interest in the livestock was perfected, the court still erred in its analysis of the proceeds. The court stated that “Ag Venture . . . had properly perfected its security interest in the Collateral effective as of November 30, 2007, and consequently had a perfected security interest that extended to the Proceeds as of that date.” However, because Ag Venture’s security interest in the livestock was not perfected at the time of the sale, its attached interest in the proceeds was also not perfected. The rules in § 9-315(c) and (d) that provide for perfection in proceeds apply only if the security interest was perfected in the original collateral. Because Ag Venture’s security interest in the livestock in the livestock was unperfected when the debtor sold the cows, Ag Venture’s security interest in the check was also unperfected, at least initially.

Nevertheless, the court may have reached the correct result, albeit for the wrong reason. Ag Venture’s security interest undeniably did attach to the check that the debtor received in payment for the cows. Because a security interest in an instrument can be perfected by filing, see § 9-312(a), the question should be whether Ag Venture’s subsequently filed financing statement covered the check. The filing did not mention “checks” or “instruments,” but it did refer to “proceeds” of livestock. Section 9-108(b) expressly provides that a financing statement’s description of collateral is sufficient if it describes the collateral by “category” or by “type of collateral defined in” the UCC. “Proceeds” is a defined term. Is it a “type of collateral” or a “category”? Perhaps. Even if not, it may still be a description that reasonably identifies the collateral, and that is all that is required. See § 9-108(a). Thus, Ag Venture’s security interest in the check may have been perfected, but not because its security interest in the livestock was perfected.

The court then proceeded to deal with priority, concluding that Ag Venture’s security interest in the check did indeed have priority. In doing so, the court never discussed whether Diane qualified as a holder in due course or as a protected purchaser under § 9-330. Presumably these issues were not briefed, and thus the court should not be faulted for failing to address them.

**JPMorgan Chase Bank v. MAL Corporation, 2009 WL 804049 (N.D. Ill. 2009)**

This case involves what is now commonly called a Nigerian e-mail scam. Perhaps due to its own sense that banks should be doing more to notify their customers of such scams, the court in this case imposed on the depository/collecting bank liability that exceeds the bounds of Article 4.

In this particular iteration of the common tale, the victim of the scam was a man named Levenfeld, who had received an unsolicited e-mail requesting his assistance in facilitating an international transfer of funds, in return for a 10% commission for his services as a “payment agent.” Levenfeld agreed to do so, acting on behalf of MAL Corporation, an entity of which he was the president, and the unnamed fraudfeasor sent him a cashier’s check in the amount of $375,890.

The check, of course, turned out to be counterfeit. In the meantime, Levenfeld had indorsed and presented the check for deposit at MAL’s bank, JPMorgan Chase. The same day that he made the deposit, Levenfeld authorized an Article 4A payment order from MAL’s account to the fraudfeasor’s account at a Japanese bank, in the amount of about 90% of the check’s face value. The check was returned unpaid six days later, and the bank charged the amount of the check against MAL’s account, causing the account to become overdrawn by over $330,000.

JPMorgan Chase then brought suit against MAL under a number of theories, including breach of contract, breach of transfer warranty, and its right of chargeback, among others. MAL raised a host of affirmative defenses in return. While the court properly dismissed the unjust enrichment and failure of consideration/bad faith affirmative defenses, it allowed suit to continue on the defenses of unclean hands, estoppel, inadequate notice, failure to mitigate, and waiver. In so doing, the court apparently was persuaded by MAL’s contention that JPMorgan Chase may have violated reasonable commercial standards of fair dealing if it recognized the hallmarks of a Nigerian e-mail scam and failed to investigate, allowing MAL to have access to the funds via provisional credit while check processing was pending.

There are several problems with the court’s holding. First, Regulation CC requires that funds associated with cashier’s checks be made available on the first banking day following the banking day of deposit, contravening any intimation that the bank acted wrongfully in making the funds available prior to investigation of the check. The bank would not have had time to investigate the check – even had this been its duty in this case, which it was not – prior
to making funds available according to the requirements of Regulation CC.

In addition, it was Levenfeld, rather than the bank, who possessed superior knowledge in this case regarding the doubtful collectability of the check. Nowhere do the facts suggest that he informed any bank representative that he had received the check after responding to an unsolicited e-mail. Furthermore, and most pertinent, Article 4 simply does not impose on a depositary/collecting bank the kind of investigative responsibility that the court seems to countenance. Instead, § 4-202(1) imposes a duty of “ordinary care” with respect to a limited list of tasks: “presenting an item or sending it for presentment,” “sending notice of dishonor or nonpayment,” “settling for an item when the bank receives final settlement,” “making or providing for any necessary protest,” and “notifying its transferor of any loss or delay in transit within a reasonable time after discovery thereof.” MAL’s affirmative defenses do not relate to any of these tasks, but instead seek to impose upon the bank a duty of care beyond § 4-202(1). In addition, as Fred Miller points out in his Hawkland’s UCC Series treatise, applying § 4-103(5), a bank would be liable for violating its § 4-202 duty of care “only if it can be shown that had the bank exercised ordinary care the item would have been collected.” 5 Hawkland UCC Series § 4-202:1. In this case, because the check in question was counterfeit, there was no chance that it would have been collected, and thus the bank should have no liability to MAL under this theory. As Professor Miller further states, although there are some instances in which § 1-103(b) would permit a common-law negligence claim to supplement Article 4, such cases should be limited to situations in which “a bank acted negligently outside of the collection process, as in failing to make a proper credit investigation.” 1 Hawkland UCC Series § 4-202:1.

MAL also contended that JPMorgan Chase acted in bad faith by “misrepresenting to MAL on Chase’s website or through its agents that the check had ‘cleared.’” Based on the totality of MAL’s argument, it appears that the only factual support for this claim is the fact that the bank gave MAL a provisional credit for the full amount which, as previously discussed, the bank was required to do under Regulation CC. In addition to the tenuous factual support for this contention, it is important to note that § 4-201(1) imposes what Official Comment 2 terms a “strong presumption” that the credit given for an item prior to final settlement is merely provisional. Given this language, to imply that the bank should have emphasized the provisional nature of the settlement seems unreasonable.

Given the unfortunate prevalence of Nigerian e-mail scams at this time, decisions like this one are particularly disturbing, in that they would seem to allow a bank customer – even a relatively sophisticated one such as the president of a corporation – to ignore common sense, be taken in by a scheme that is on its face “too good to be true,” and then seek to pass off the results of its own bad decision onto the bank.

**Ludwig v. Fifth Third Bank,**

908 N.E.2d 992 (Ohio Ct. App. 2009)

This case involves an individual named Ludwig who was swindled by Thornton, a former co-worker. Ludwig continued to receive commission checks from his former employer for business he generated prior to his departure. After Ludwig’s new employer and former employer entered into litigation with one another, Ludwig felt uncomfortable continuing to accept the checks until the matter was settled. For this reason, Ludwig brought the one commission check he had already received to Thornton, and asked him to hold the check during the pendency of the litigation. Instead of doing so, Thornton deposited the check without indorsement into his own personal account with Fifth Third Bank. Thornton also intercepted and deposited without indorsement eight more commission checks.

Upon discovering Thornton’s conduct, Ludwig sued Fifth Third Bank for conversion. The trial court granted summary judgment for the bank, and the court of appeals affirmed in part, reversed in part, and remanded the case for further proceedings regarding the first of the nine converted checks.

With respect to the eight checks that Thornton intercepted, the court ruled that Ludwig could not maintain a cause of action for conversion due to the language of § 3-420(a). That provision bars an action for conversion of an instrument by a payee “who did not receive delivery of the instrument either directly or through delivery to an agent or a co-payee.” In applying this rule, the court reasoned that Thornton was not Ludwig’s agent because, according to Ludwig’s own testimony, Ludwig “had never authorized Thornton to receive checks on his behalf, . . . had never authorized Thornton to sign his name on checks, . . . [and] had never told a third party that Thornton had the right to accept payment from him.”

It appears that the court may be conflating two arguably different issues: whether a person is an agent of another; and whether an agent has exceeded its authority. Ludwig undeniably had authorized Thornton to hold checks for him. Therefore, Thornton was Ludwig’s agent. Thornton may have exceeded the scope of his agency, but it’s not clear that this should negate delivery to Ludwig within the meaning of § 3-420(a). Nevertheless, the court’s analysis is at least consistent with the policy behind § 3-420(a). As the comments point out, the payee who never receives delivery does not need a claim in conversion because the payee can still go after the drawer on the obligation that the check was intended to pay. In other words, Ludwig could go after his former employer for the commissions due. The drawer, in turn, could prevent the drawer from charging the drawer’s account because the item was not properly payable. The check was payable to the order of Ludwig, but the drawer paid Thornton. The drawer, in turn, could go after the depositary bank for breach of a presentment warranty under § 3-417(a)(1).

As to the one check that Ludwig had received and turned over to Thornton, the court correctly noted that § 3-420 was no bar to a conversion action. Fifth Third Bank claimed that Ludwig was contributory negligent in giving possession to Thornton, and therefore precluded from recovery under § 3-406(a), but the appellate court correctly noted that this section was not relevant. It applies only when an instrument is altered or a signature is forged, and neither of those had occurred. Nevertheless, the court remanded the case for further proceedings. This is the most troubling aspect of the decision. The court characterized Ludwig’s conduct in turning over the first commission check to Thornton as “perhaps careless,” and concluded therefore that factual issues precluded summary judgment. Yet it is far from clear whether, or why, that should matter. Because Fifth Third accepted the check from Thornton without indorsement, the bank could not qualify as a holder within the meaning of § 1-201(b)(21)(A), much less a holder in due course within the meaning of § 3-302. As a
result, the bank had no right to enforce the instrument under § 3-301 and had no property rights in the instrument. Indeed, the bank’s rights in the instrument were no greater than what its transferor, Thornton, had, which is to say none at all. Remand should not have been necessary.

_in re Jersey Tractor Trailer Training, Inc.,_ 2009 WL 2750458 (3d Cir. 2009)

We have reported on this case twice before: in a special December 2007 edition of this column we reported on the Bankruptcy Court’s decision; and in the October 2008 column, we reported on the District Court decision. In both we criticized the court’s analysis of a priority dispute between two accounts’ financiers. In particular, we regarded as absurd the underlying unsupported premise — not actually decided — that a factor could be a holder in due course of accounts or that the debtor’s invoices to its customers were negotiable instruments. We also criticized the Bankruptcy Court’s conclusion that the second factor had acted in bad faith because its search firm had searched under an abbreviated name of the debtor and therefore failed to discover a proper filing by the first factor. We found the affirmation of that decision even more distressing because the District Court had ruled that the second factor “had a duty to search both the debtor’s correct corporate name, as well as roots of that name.”

Well, perhaps this column is having some effect. Although neither of our prior discussions were cited in its opinion, the Third Circuit rejected both lower courts’ analysis of good faith and remanded the case for further proceedings. In doing so, the Circuit Court quite properly noted that good faith — which requires that parties act in conformity with reasonable commercial standards of fair dealing — “is concerned with the fairness of conduct rather than the care with which an act is performed” (quoting § 3-103 cmt. 4) (emphasis added by the court). The court then concluded that the fact that search against “Jersey Tractor Trailer Training” instead of “Jersey Tractor Trailer Training, Inc.” did not reveal the first factor’s lien was “anomalous,” but not evidence of bad faith.

Unfortunately, the case is not over. The Circuit Court remanded to the Bankruptcy Court to determine whether the second factor’s investigation of the debtor’s business was sufficient to meet its duty to deal fairly in purchasing the debtor’s accounts. In doing so, the court did not address the underlying and ridiculous premises of the second factor’s arguments, including the wholly unexplained assumption that the debtor’s invoices to its customer could be negotiable instruments. Perhaps the Bankruptcy Court will finish the job the Third Circuit has started in cleaning up this mess.

_in re Trout_, 2009 WL 2905923 (Bankr. S.D. Ill. 2009)

This fairly simple case deals with perfection in fixtures. The court began its analysis by citing and quoting all the relevant provisions, but then it badly misinterpreted them.

The case arose when the debtors contracted for the purchase and installation of an energy guard insulation blanket in their home. The energy guard was installed in the attic, cut to fit the contours of the house, and nailed down. The seller retained a security interest in the energy guard but did not file a financing statement or record a mortgage. The seller later assigned the contract to American General Financial Service, Inc.

The debtors filed for Chapter 13 bankruptcy protection and sought to treat American as unsecured, claiming the security interest was not perfected. The court began by quoting the definitions of “consumer goods” and “fixtures,” the automatic perfection rule of § 9-309(1), and the priority rules in § 9-334. The court then correctly noted that “[w]hile the energy guard falls within the definition of “consumer goods,” it also could fall within the definition of a “fixture.”

But from here the court seemed to misunderstand the provisions it had just quoted. The court then wrote that if the energy guard is a fixture, “then a fixture filing or a filed mortgage would be required to create a secured debt.” This is wrong on several levels. First, the statement confuses attachment with perfection. Even if a fixture filing were necessary, that filing would at most be relevant to perfection, not attachment. Second, even assuming the court meant to refer to perfection (or meant that, if the security interest was unperfected, the security interest could be avoided in bankruptcy), the court was simply wrong. The seller’s security interest was perfected under § 9-309(1) because, as the court itself had acknowledged, it was a purchase-money security interest in consumer goods. The absence of a fixture filing or recorded mortgage might be relevant to priority over a mortgagee, but not to perfection. This point is quite evident from the language of the Code and is fully acknowledged in the comments. See § 9-334 cmt. 8 (noting that automatically perfected PMSI in certain consumer goods that are fixtures has priority over a prior mortgage).

It is possible that the court simply stumbled over terminology. Section 9-334(a), after providing that a security interest may be created in goods that are fixtures or continue in goods that become fixtures, then states that “[a] security interest does not exist under this Article in ordinary building materials incorporated into an improvement on land.” In other words, Article 9 recognizes three classifications of realty-related goods:

♦ Goods may have such an incidental relationship to real estate that they remain personal property for all purposes, and a real estate mortgage would transfer no interest in them. A likely example would be a gas grill on a back yard patio.

♦ Goods may be so incorporated into real estate that they completely lose their character as personal property. This is what the last sentence of § 9-334(a) is speaking about. Drywall and lumber used in framing a house are examples. No Article 9 security interest can exist in such property.

♦ Goods may qualify as “fixtures,” and thereby straddle the line between personal property and real property. An interest in such goods can exist or be created under both Article 9 and real estate law.
See § 9-334 cmt. 3.

If the court had meant that the energy guard fell into the second category above—i.e., it is real estate—then its ultimate conclusion that American had no security interest at all may well have been correct. Unfortunately, the court was quite clear in stating that the energy guard was a fixture—that is, it fell into the third category above— and in reaching that conclusion the court relied upon several cases that purported to delineate what qualifies as fixtures, not what personal property becomes so incorporated into a structure that it ceases to be goods at all. If one is to accept as correct the court’s conclusion that the energy guard was a fixture, then American’s security interest really was perfected and American should not have lost.

Useful Links and Websites

Compiled by Carol Nulty Doody, Uniform Commercial Code Committee Editor

Please find below a list of electronic links that our members may find useful:

1. The UCCLA-L listerv, which is sponsored by West Group, publisher of the “UCC Reporting Service.” To subscribe to the UCCLA-L listerv, click here.
2. U. Penn’s archive of NCCUSL final acts and drafts can be accessed here.
3. Pace University’s database of CISG decisions can be accessed here.
4. Gonzaga University’s new Commercial Law Center has a variety of links to useful sites and can be accessed here.
5. The International Association of Commercial Administrators (IACA) maintains links to state model administrative rules (MARS) and contact information for state level UCC administrators. That information can be accessed here.
6. The Uniform Law Commissioners maintains information regarding legislative reports and information regarding upcoming meetings, including Joint Review Committee for Uniform Commercial Code Article 9. You can access this information here.
8. Information on the work of the OAS in the area of private international law and the various Inter-American Specialized Conferences on Private International Law organized by the OAS is available here.
9. Information on The National Law Center for Inter-American Free Trade (NLCIFT) and its work throughout Latin America to promote secured transactions reform is available here.
10. Information on the Hague Convention and its current status is available here.
11. Information on the UNIDROIT project to enhance the internal adequacy and cross-border compatibility of existing national laws, including the Draft Convention on Substantive Rules Regarding Intermediated Securities, is available here.

In addition, the Commercial Finance Committee's Task Force on Surveys of State Commercial Laws website links to surveys of the law of all 50 states (except Connecticut, DC and Puerto Rico).

With your help, our list of electronic resources will continue to grow. Please feel free to forward other electronic resources you would like to see included in future editions of the Commercial Law Newsletter, by sending them to Christine Gould Hamm or Lauren E. Wallace, the Commercial Finance Committee Editors, or Carol Nulty Doody, the Uniform Commercial Code Committee Editor.
General Counsel of the UCC Division of First American Title Insurance Company, with the much needed assistance of Richard K. Brown, Winston & Strawn LLP and Richard L. Goldfarb, Stoel Rives LLP.


Lifted from Ken Kettering’s Syllabus for his Secured Transaction’s class.

Notice that in the sale-with-retained-security-interest transaction, M’s profit (that is, the difference between the price M is obliged to pay O and the higher price at which M resells the painting) is economically equivalent to the commission that M is entitled to retain in the consignment arrangement.

It is common to use the word “true” to denote a transaction that should not be recharacterized as a lien transaction. Thus, one may speak of a “true consignment,” a “true lease,” or a “true sale (of receivables).”


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This premium amount is doubled in the case of commercial passenger airline or airline catering services whose defined benefit plans are terminated during the first five years after the sponsor elects certain special.

It is unclear from the court’s opinion whether the livestock of Michael or of MHI was used as collateral, but the court seems to presume it was MHI’s livestock.

In fact, the check had been deposited into a client trust account maintained by Diane’s attorney, but the court and the parties seem to have ignored whether that fact had any effect on the analysis.